No. 15821

United States Court of Appeals
For the Ninth Circuit

JOHN R. HANSEN and SHIRLEY G. HANSEN, *Petitioners,*

vs.

COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

BRIEF OF AMICI CURIAE

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United States Court of Appeals
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BRIEF OF AMICI CURIAE

With leave of the Court, this brief is filed by the undersigned attorneys as *amici curiae* in the interest of various clients and other taxpayers who will be substantially affected by the decision in this case. Determination of the legal issue here presented will have fundamental implications to many taxpayers throughout the United States. There are many cases, in various stages of litigation, which will be directly affected by this decision.[1] There are presently pending in several other courts of appeal cases involving the fundamental principles to be decided in this case.[2]

SCOPE OF THE BRIEF

This brief is confined to a discussion of only one issue involved in this case. That issue is whether a dealer selling tangible, personal property on a deferred payment plan and using the accrual system of accounting should be required to take into income credits made by the

[1] See Brief p. 17-21

[2] See Brief p. 19

financing institution to its "dealer's reserve account" at the time such credits are entered on the financing institution's books even though not available to the dealer.

The Tax Court in a recent series of cases has upheld the position of the Commissioner that dealer's system of accrual accounting, which reports these amounts in the year in which they become available to the dealer, is incorrect and that said credits to the dealer reserve account by the financing institution are taxable to the dealer in the year the amounts are credited to "a dealer reserve account" on the financing institution's books.

The various courts of appeal which have considered this question have uniformly reversed the Tax Court and the Commissioner and held that the dealer's accrual system is correct and such credits need not be accrued as income until the amounts carried in the reserves become available to the dealer.

As to the other points which may be here involved we express no opinion.

FACTS WITH RESPECT TO THE POINTS HEREIN ARGUED

The fundamental facts, with which this brief is concerned, involve a pattern of financing widely used and long established in the businesses of selling automobiles, trailers and similar property.

The factual pattern of this type of business as illustrated by this case involves three parties — the purchaser who desires to buy the article (be it a car, trailer, or other similar tangible property), the financing institution which supplies the money to the purchaser, and the dealer who sells the article to the purchaser. The purchaser, at the time he buys the article, makes a down payment in the form of cash or a trade-in to the dealer and at the same time agrees to make a certain number of equal monthly installments to the financing institution. The dealer thereupon delivers the article to the buyer and the financing institution's contract signed by the purchaser is delivered to the financing institution which collects it. The total price contained in the contract is a "deferred time balance," which will usually include the cash sale price of the article sold, charges for taxes and insurance, and a financing service charge. By agreement between the dealer and the financing institution, the dealer receives an advance from the financing institution of a major portion of the invoice price of the article sold. Taxes and insurance are usually paid at the time of sale and the manner of handling these payments is not important for our purposes. The remaining amount of the purchaser's total obligation, set forth in the contract, is reflected on the books

of the financing institution, the dealer and the purchaser by a series of accounting entries.

A. Financing Institution Procedure

The financing institution establishes on its books a deferred income account for that portion of the finance charge which it may earn and an account reflecting the return of principal. The amounts received by the financing institution from the purchaser are each apportioned between a return of principal and a payment of the finance charge as payments are made on the contract, and the finance charge is not taken into income by the financing institution until such time as each increment is paid by the purchaser.

The remaining amount of the purchaser's obligation, which has not been credited to the deferred income account of the financing institution, is credited to a "dealer's reserve account" on the financing institution's books. The amounts credited to this account consist of a portion of the cash sale price of the article sold (for example—5%), which the financing institution refuses to advance, and a portion of the finance charge which financing institution will share with the dealer if the financing charge is earned. If the purchaser should prepay the contract or default on his payments, then the contract financing charge will not be earned and the financing institution will have no finance charge to share with the dealer. Similarly, in case of default the financing institution will not advance or pay to the dealer the remainder of the invoice price.

The agreement between the financing institution and

the dealer is a general one and covers a large number of separate transactions with many individual purchasers. One of the terms of this agreement is that no amounts will be made available by the financing institution to the dealer from this "dealer reserve account" until such time as the amounts credited by the financing institution to the "dealer's reserve account" exceed a certain percentage of the total amount of contracts which the dealer and financing institution have entered into with respect to purchasers buying articles from the dealer. The amount of this percentage may vary, and sometimes is in the complete discretion of the financing institution, but in no case is the financing institution obligated to make available to the dealer any amounts whether credited to the "dealer reserve account" or not until the terms of the agreement between the parties have been met.

B. Dealer Procedure

The accrual accounting system of the dealer for this same transaction has a sales account in which is reflected the money which the dealer receives as cash or trade-in from the purchaser, plus the amount advanced by the financing institution to the purchaser to finance the sale. The amount received from the financing institution is the invoice price of the article less a portion of the invoice price which the financing institution refuses to advance. In the event 5% was not advanced the dealer would receive 95% of the cash sale price. The additional amounts to which the dealer may later become entitled, which would be the 5% of the cash sale price, plus a portion of the finance charge, are either not re-

corded at all by the dealer, or are recorded on a memorandum record kept for information purposes. These amounts will never be received unless the financing institution not only collects the full contract balance from the purchaser but also won't be received unless the financing institution has collected the amounts from other purchasers to secure itself against losses provided for in the general agreement between financing institution and dealer. In the event that the financing institution should make available to the dealer some amounts from the reserve account which it has established on its books, the dealer at that time takes these amounts into income.

C. Purchaser Procedure

The purchaser, if on an accrual basis, at the time he obtains the article and signs the deferred balance contract enters the value of the article as an asset and the contract as a liability on his balance sheet. The amount owing as a finance charge is not deducted as an expense by the purchaser at the time of the signing of the contract, but is deducted each year as it becomes due and payable under the contract.

STATUTES INVOLVED

The statutes involved are Sections 41 and 42a of the Internal Revenue Code of 1939. These sections are set forth at length in IA of the Argument.

ARGUMENT

I.

The Accrual Accounting System of the Taxpayer Properly Reflects the Income Received by Taxpayer in His Business and To Be Required to Change to the Artificial Position Demanded by the Commissioner Would Destroy the Taxpayer's Business

A. The Taxpayer's Accrual Accounting System Properly Reflects Net Taxable Income as Required by the Internal Revenue Code as Interpreted by the United States Supreme Court

The fundamental problem involved concerning the taxation of the so-called credits to "dealer reserves" is to determine the point in time when the dealer has received income on which federal income tax must be paid. The Internal Revenue Code of 1939 succinctly covered this situation in two sections—41 and 42(a)—which provided as follows:

> "SEC. 41. GENERAL RULE.
>
> "The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. . . ."
>
> "SEC. 42. PERIOD IN WHICH ITEMS OF GROSS INCOME INCLUDED.
>
> "(a) General Rule—The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the tax-

> payer, unless, under methods of accounting permitted under Section 41, any such amounts are to be properly accounted for as of a different period. . . ."

The principles embodied in the above-cited sections have been carried over without any basic change into the Internal Revenue Code of 1954 as Secs. 441, 446 and 451.

All taxpayers, concerned with this "dealer reserve issue," are required to keep their books on an accrual accounting basis because they maintain inventories. I.R.C. (1939) §22(c). Treasury Reg. 111, §29.41-2, followed by Reg. 118, §39.41-2.

It is clear from the above-cited statutes that a starting point of any issue involving the taxpayer's method of reporting his income is that taxpayer should report in accordance with the method of accounting regularly employed in keeping his books. The taxpayer in this case has done so.

This method should be upset only if the method employed does not clearly reflect the income of the taxpayer, in which case the Commissioner has the right to designate a method which does clearly reflect income. This fundamental requirement of a clear reflection of income means that the taxpayer's business must be examined to determine its actual mechanical workings and then the taxpayer's method of accounting for his business transactions must be compared with the taxpayer's business to determine whether the taxpayer's accounting system clearly reflects income, or, if it does not, whether the Commissioner has a system which does clearly reflect income.

Two United States Supreme Court opinions many years ago established the basic tests which an accrual accounting system must pass in order clearly to reflect income. The case of *North American Oil Consolidated v. Burnett,* 286 U.S. 417, 424, 76 L.Ed. 1197, 1200, established the concept of income being reportable when the taxpayer receives earnings under a "claim of right."

This case was followed the next year by *Spring City Foundry Co. v. Comm.,* 292 U.S. 182, 78 L.Ed. 1200, which established that it is the "right to receive" and not the actual receipt of income that determines its inclusion in gross income when using the accrual accounting system.

This principle must not be artificially applied, and the respondent Commissioner in other cases takes the position that substance, not form, must govern. This view has been followed on this issue by the Appellate Courts. As was stated by the Fourth Circuit in *Blaine, Johnson v. Comm.,* 233 F.(2d) 952 (4th Cir. 1956), when commenting on this "dealer reserve" taxation at page 957:

> "Taxation is a practical matter; the substance of what is done and not the form must govern."

When we examine the substance of the transactions involved in these cases, we find that the sale of automobiles or house trailers is not like selling a house in that the items are very mobile and the purchasers are of relatively insecure financial status. The elements of risk and the volume of financing required limit the market for normal financing of the commercial paper involved in these sales and create the necessity for specialized

financing arrangements. In many cases, this has caused the creation of specialized financing institutions, such as General Motors Acceptance Corporation and Universal C.I.T. These institutions operate almost exclusively in financing these operations.

An examination of these sales reveals that they are three-cornered transactions involving a dealer, a purchaser, and a financing institution, all of whom are necessary before the article can be sold. The degree of control by the financing institution over the transaction varies from case to case, usually depending upon the financial strength of the dealer and his ability to bargain with the financing institution. In all cases, however, the financing institution exercises a degree of control over the dealer and is considered in the transaction from the beginning. As can be seen from the facts that in this case (and in general practice) the original contract is made on the financing institution's form, and at all times the parties involved recognize that the purchaser will make payments directly to the financing institution.

The contract signed by the purchaser provides that the purchaser will make a series of equal monthly payments to the financing institution, each of which contains a partial payment on the purchase price and a partial payment on the financing charge. The financing institution, as it receives these payments, credits part to principal and part to its income account. The financing institution pays income tax on the purchaser's contract only as it receives the payments from the purchaser, since there is no "right to receive" any finance charges

from the purchaser in the event that the purchaser prepays the contract or the item is repossessed. *Motor Securities Co., Inc.,* Par. 52,316 P-H Memo, T.C.

The dealer in this transaction receives from the purchaser a partial down payment on the merchandise and receives from the finance company a partial payment on the remaining balance due on the purchase price of the merchandise. The dealer does not receive the full value of the merchandise sold because the financing institution refuses to advance a portion of the purchase price which, on the financing institution's books, is credited to the "dealer's reserve account." In addition to this amount not advanced to the dealer, the financing institution will generally agree with the dealer (depending upon the bargaining power of the dealer and the respective financing institution) to pay to the dealer a portion of the finance charge to be collected from the purchaser in the event that said financing charge is fully collected. An amount representing the dealer's share of the anticipated profits, if collected, is also credited to the "dealer's reserve account" on the financing company's books at the time the company first receives the contract from the purchaser. Whether or not the dealer actually receives *anything* from the financing institution sometimes is solely in the discretion of the financing institution, and other times depends upon the credits to the dealer on the financing institution's books to his "dealer reserve account" exceeding a certain arbitrary figure. This "dealer reserve account" may never reach this figure because this reserve account is reduced on the financing institution's books whenever the finance charge is not

collected from the purchaser or the financing institution suffers a loss on the financing developed through the particular dealer.

The taxpayer's accounting system reflects income from the financing institution when the dealer has amounts made available to him by the financing institution. This is completely proper and the only method which clearly reflects the taxpayer's income because in no case does the dealer have a "right to receive" or "claim of right" to any funds in the hands of the financing institution until the purchaser pays the financing institution and, by the requirements of the agreement between the dealer and the financing institution, there is an obligation by the financing institution to the dealer. In none of the cases involving these credits to the "dealer's reserve" does the dealer have any right to any amounts in the hands of the financing institution simply because they are credited to a "dealer reserve account" and the Commissioner has in no case demonstrated any right which the taxpayer has to such funds which should cause the taxpayer to be required to change his system of accounting in order to more "clearly reflect income."

B. To Follow the Commissioner's Requirements Would Distort the Accounting System and Not Clearly Reflect the Income Derived from the Transaction

The Commissioner's position (as shown by his recent argument in *Texas Trailer Coach, Inc., v. Comm.*, 1 A.F.T.R.2d 58-533) is that there are two separate transactions in the sale of the merchandise and that the credit by the financing company to a "dealer reserve

account'' on the financing institution's books is income to the dealer which must be accrued at the time such entry is made. This is a theoretical analysis which does not reflect the realities of the business transaction, nor the rights of the respective parties. If the taxpayer-dealer were to follow this system, he would be creating income before it came into existence, since the dealer has no claim of right and, in fact, no claim at all to any of the ''dealer reserve account'' until the purchaser has paid and the financing institution's requirements with respect to the dealer have been completed. The financing institution itself is not required to take these into income until the purchaser makes payments. *Motor Securities Co., Inc., supra.*

Only recently in the field of ''patronage refund credits'' the Court of Appeals for the Fourth Circuit held that a taxpayer on the accrual basis did not receive income through the crediting of a patronage refund credit to his account on the books of a cooperative where such credit was subject to diminution because of various contingencies contained in the agreement between the taxpayer and the cooperative. *Long Poultry Farms v. Comm.,* 249 F.2d 726 (C.A. 4th, 1957). The Internal Revenue Service has now announced that it will follow the court decisions culminating in *Long Poultry Farms, supra.* See Rev. Rul. 57-358, IRB. 1957-32 Par. 54,503 P-H Fed. Tax Ser. (1958). The issue involved in that case is almost identical to the situation at bar.

The taxpayer-dealer does not have a right to receive anything from the financing institution until the conditions of the agreement have been met. The dealers in

many cases have the duty of serving the contracts, completing repossessions, and handling other complaints of the purchaser. In a very similar situation, the Tax Court, in the case of commission accruals to an insurance company's general agent's account, held that the agent was not taxable on such credits until the credits were subject to petitioner's unrestricted use and enjoyment. *Leedy-Glover Realty & Insurance Co.,* 13 T.C. 95, 106 (1949). In that case the agent's commissions were in existence and were placed in escrow pending the passage of time until the premium had been paid for each year and the serving required by the agent had been completed. This goes far beyond the case at bar where the moneys are not yet even in existence, so far as the purchaser's making payments on the contract are concerned.

C. To Ignore the Realities of the Business Transaction and Distort This Type of Accounting System Can Destroy the Businesses of Many Small Growing Dealers

The distortion of reporting income, requested by Commissioner, is not merely a shifting of income from one year to another with harmless over-all effect. Instead, the shifting of income sought by Commissioner makes it impossible for small expanding businesses to pay their taxes. Hence, the issue is of grave importance to many taxpayers.

A simple example of what the effect is follows: Assume a taxpayer starts in the automobile or trailer sales business in 1948 with a capital of $25,000 and that after paying the necessary fixed expenses of the business he has $20,000 available for financing his inven-

tory. With this he purchases ten $2,000 automobiles which sell for $2,500 and on which, if sold on a three-year contract, there would be a $500 finance charge, leaving the purchaser with a $3,000 contract. Placing this in chart form the following is apparent by using Commissioner's position:

Contract Price	$3,000.00
Finance Charge	500.00
Car Price	2,500.00
Cost	2,000.00
Gross Profit	500.00
Selling Expenses	300.00
Net Profit If Received $2500.00	200.00
Taxes (30% on $200)	60.00
Profit After Tax	140.00
Not Advanced by Finance Co.— 5% of $2,500	125.00
Return to Dealer	15.00
Tax on Reserve (30% tax on $100 split to dealer of finance charge)	30.00
Net Cash Loss on Each Transaction	(15.00)

By projecting this cash loss in each transaction the following is apparent:

	1948 (250 cars sold)	1949 (500 cars sold)	1950 (1000 cars sold)
Net cash loss	($3,750.00)	($ 7,500.00)	($15,000.00)
Cumulative cash deficit	($3,750.00)	($11,250.00)	($26,250.00)

It is undisputed the dealer is not entitled to any of the unadvanced amounts held by the finance company, nor any splitting of the finance charge until such time as the dealer's reserve has exceeded a certain percentage of the total contracts being held by the financing institution. Most of these contracts run two or three years, and as long as business increases there is no return at all. It is readily apparent that the dealer suffers a net cash loss of $15.00 each time an automobile is sold if he pays tax on money he has no right to receive. Assuming his business increases each year (which is the pattern of this business), the first year he has a $3,750 cash deficit, which means he has no funds to continue his inventory at ten cars. The next year he has a $11,250.00 cash deficit. The third year he has a $26,250 cash deficit. This means that before the third year has been completed his capital of $20,000 has been more than completely wiped out, he has been unable to pay his taxes and is out of business. The dealer is not entitled to share in the finance charge until such time as the contract has been paid out (usually two to three years), and he has in the reserve account an amount in excess of a certain percentage of the contracts held by the financing company (which he cannot do, since the number of contracts is going up each year and he never arrives at the percentage). We find that the dealer is soon taxed out of existence. The reason for this result is the imposition of a tax on items which the dealer has no right to receive and cannot even consider an asset for the purpose of borrowing or otherwise strengthening his cash position. In the field of trailer sales this situation is even more difficult, since the contracts run for longer periods (five

to seven years), which means that the dealer does not receive any payments from the financing institution for as long as five to seven years and in the meantime, using the Commissioner's argument, a tax bill of tremendous proportion has built up on these funds which are not available to him. As can be seen from the example, the dealer could only pay $15 toward the $30 owing because of taxes on the reserve, and $125 not available, so penalties and interest also are incurred.

These principles have been well stated by the various courts of appeal in reversing the Tax Court. The case of *Long Poultry Farms v. Commissioner,* 249 F.(2d) 726, 730 (C.A. 4th 1957), involving patronage refunds, is a recent pronouncement of a court of appeal on this subject of taxing credits. That case holds these credits not taxable when credited and quotes from *Johnson v. Commissioner,* 233 F.(2d) 952 (C.A. 4th 1956), in which the court, in deciding the precise issue before this court, held that sums withheld by a financing institution for amounts due taxpayer and credited to him on a reserve account were not taxable to the taxpayer until the year in which the right to receive them became fixed.

The taxpayer-dealer in these cases may never receive the income on which he has paid tax. Since he has no fixed right to receive anything in the year in which amounts are credited to an account on the financing institution's books to tax him on these credits will, in a short period, destroy the taxpayer's business by completely depleting his working capital and imposing on him penalties and interest for taxes he simply cannot obtain the funds to pay.

II.

The Courts Other Than the Tax Court Generally Hold That the Taxpayer Should Not Be Taxed on Credits to a Dealer's Reserve Until the Funds Are Available to Him Under the Terms of His Agreement with the Financing Institution

There is no question in these "dealer reserve" cases that the dealer will be taxed on the amount which he receives as income. The question is one of whether the dealer will be taxed on an artificial concept of income which may or may not ever become income in fact.

A. The Courts of Appeals Have Uniformly Held Taxpayers Not Taxable on Credits to the Reserve

The principle of the non-taxability of these "dealer reserves" was long ago established by the Third Circuit in *Keasbey & Mattison Co. v. U. S.,* 141 F.(2d) 163 (3rd Cir. 1944).

There are several recent Court of Appeals opinions on this issue which have followed *Keasey & Mattison Co. v. U. S., supra,* and have rejected the Commissioner's attempts to tax the dealers on the "dealer reserve account" credits.

> *Johnson v. Comm.,* 233 F.(2d) 952 (4th Cir. 1956);
>
> *Texas Trailer Coach, Inc., v. Comm.,* 1 A.F. T.R.2d 58-533 (5th Cir. 1957);
>
> *West Pontiac, Inc., v. Comm.,* 1 A.F.T.R.2d 58-839 (5th Cir. 1957).

All of the above cases hold that "dealer reserve" credits are not taxable to the dealer at the time the credit is made on the financing institution's books.

The issue is presently pending before the following circuits in the following cases:

Schaeffer v. Comm., 6th Cir. No. 13421—argued April 10, 1958;

Baird v. Comm., 7th Cir. No. 12230—set for argument April 24, 1958;

Glover v. Comm., 8th Cir. No. 15877—argued March 7, 1958;

Hansen v. Comm., 9th Cir. No. 15821—set for argument May 13, 1958.

In addition to the above-listed cases, the following cases have been decided adversely to the taxpayer in the Tax Court and may, by the date of this brief, also be on appeal:

Albert M. Brodsky, 27 T.C. 216, decided October 17, 1957 (9th Cir.);

Arthur Morgan, 29 T.C. No. 9, decided October 17, 1957 (9th Cir.);

Charles M. Kilborn, 29 T.C. No. 14, decided October 24, 1957 (5th Cir.);

Vance L. Wiley, Par. 57,236 P-H Memo T.C., decided December 23, 1957 (6th Cir.).

The most recent Court of Appeals opinion analyzing this issue is *Texas Trailer Coach, Inc., v. Comm., supra*, in which the court makes a very detailed analysis of the pattern of these transactions and the authorities and concludes as follows:

> "This case shakes down to a few basic facts. In each credit sale of a trailer, the obligations of the purchaser, dealer and finance company were inextricably interwoven in a single three-party agreement. The agreement gave the finance com-

pany virtually complete control over 5% of the unpaid purchase price. The finance company exercised its control by withholding this 5% in a special dealer's reserve account surrounded by various conditions precedent to payment. These conditions were contingencies which might have barred indefinitely the dealer's receipt of payments or right to receive payments from the account. One of these contingencies, the proviso that the account exceeds 15% of the unpaid balance on all trailer contracts effectively barred the dealer from receiving or having the right to receive any amounts from the reserve account until nearly the end of the third year of the dealer's corporate existence. We hold, therefore, without generalizing beyond the logical necessities inherent in the facts of this case, that the amounts in this dealer's reserve account were contingent credits. They did not accrue in the taxable year when the finance company withheld the amounts and credited them on its books to the taxpayer."

B. The United States District Courts Have Uniformly Held Taxpayers Not Taxable on Credits to Such Reserve Accounts

The United States District Courts which have recently considered this matter have uniformly held that "dealer reserves" are not taxable to the dealer until payments are received from him. It is not believed that the Commissioner has appealed any of these cases.

Massey Motors, Inc., v. U. S., 156 F.Supp. 516, 157 P-H P 72,989 (D.C. Fla., Oct. 7, 1957, amended Nov. 6, 1957);

Modern Olds, Inc., v. U. S., ... F.Supp. ......, 1 A.F.T.R.2d 58-732 (N.D. Tex., Dec. 17, 1957);

Hines Pontiac v. U. S., ... F.Supp. ......, 1 A.F.T.R.2d 58-734 (N.D. Tex., Dec. 18, 1957).

C. The Position of the Commissioner and the Tax Court Is Inconsistent with Good Accounting Principles and with the Treatment Accorded to the Other Taxpayers Involved in the Transaction

The first examination of these "dealer reserve accounts" in the Tax Court appears in *Shoemaker-Nash, Inc., v. Comm.,* 41 B.T. 417 (Feb. 16, 1940), wherein the court held that reserves credited to the account of the taxpayer on the financing institution's books were really of benefit to the taxpayer since they stood in place of an otherwise direct charge. In less than a year, however, the Tax Court in *Ernest G. Beaudry* (Feb. 14, 1941) distinguished the *Shoemaker-Nash* case and held that credits to a "dealer reserve account" by a financing institution were not taxable to the dealer when the amounts in the account were required to exceed 7½% of the total contracts outstanding between dealer and the financing institution before the financing institution was obligated to pay over any amounts to the dealer. The *Beaudry* decision seems to have been forgotten by the Tax Court in its recent series of decisions holding credits to these accounts to be taxable to the dealer.

The position of the Tax Court and Commissioner is inconsistent with the treatment accorded the financing institution by the Tax Court, which, in *Motor Securities, Inc.,* PP 52,316 P-H Memo T.C., holds that the amounts credited by the financing institution to its deferred income account, which arise from the same transaction and are the ultimate proceeds from which the

financing institution and dealer will be paid, are not taxable to the financing institution until such payments are received from the purchaser.

The purchaser, who is the third party to this transaction, is probably not allowed to accrue the expense of the finance charge until the payment becomes due under the terms of the contract. I.T. 3740, 1945 C.B., p. 109; see also *Security Flour Mills Company v. Comm.,* 321 U.S. 281, 88 L.Ed. 725. This taxation of the purchaser is consistent with the taxation of the financing institution which does not take these amounts into income until paid and is consistent with the position urged by the taxpayer herein. The Commissioner's taxation of the dealer on these reserves is inconsistent with the taxing of the other parties to the transaction.

D. The Established Accounting System of the Industry Properly Reflects Income and Should Not Be Distorted

The desirability of following the established system of accounting widely used by an industry which properly reflects the business realities of the transactions has been recently set forth by this court in the case of *Pacific Grape Prod. Co. v. Comm.,* 219 F.(2d) 862 (9th Cir. 1955), wherein Judge Pope states at page 869:

> "Not only do we have here a system of accounting which for years has been adopted and carried into effect by substantially all members of a large industry, but the system is one which appeals to us as so much in line with plain common sense that we are at a loss to understand what could have prompted the Commissioner to disapprove it. Contrary to his suggestion that petitioner's method did not re-

> flect its true income it seems to us that the alterations demanded by the Commissioner would wholly distort that income."

See also the dissenting opinion of Judge Opper of the Tax Court quoted in footnote 10 of the opinion.

III.
CONCLUSION

Taxpayers selling tangible merchandise on a deferred payment basis should not be taxed when their financing institution credits certain amounts to an account entitled "dealer reserve account" over which the taxpayer has no control and from which he is not entitled to any proceeds. Taxpayers should be taxed on these amounts only when they become available to them in accordance with the agreement between them and the financing institution.

Respectfully submitted,

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